

LEGISLATIVE FISCAL REPORT SPECIAL SESSION AUGUST 2002 FOR THE FISCAL 2003 BUDGET

A Report Prepared for the
57th Legislature

By the
Legislative Fiscal Division

August 20, 2002



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MONTANA LEGISLATIVE BRANCH

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August 20, 2002

Members of the 57th Legislature:

In accordance with 5-12-302, MCA, I submit the Legislative Fiscal Report for the August 2002 Special Session. This report provides an overview of the budget deficit that precipitated a special session, the revised general fund balance projection for the 2003 biennium after the special session, a summary of the legislative action enacted in special session to balance the budget, and an outlook for the remainder of this biennium and the 2005 biennium. It also includes a summary by agency of special session budget actions in the "Agency Budgets" section, and a copy of House Bill 2 as amended during special session.

Further information on the 2003 biennium budget is provided in the Legislative Fiscal Report issued after the 2001 regular session of the legislature.

This report is intended as a reference document and historical archive of legislative budget action for the use of legislators, state agencies, and the public.

Respectfully submitted,

Clayton Schenck
Legislative Fiscal Analyst

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PURPOSE OF REPORT

The 57th Legislature was called into special session to bring the general fund budget into balance as a result of a projected deficit for the 2003 biennium. The purpose of this report is to provide the legislature and interested parties a record of fiscal actions taken by the legislature during the August 2002 Special Session to resolve the budget deficit. It updates, but does not completely replace the 2003 Biennium Legislative Fiscal Report published by the Legislative Fiscal Division after the 2001 legislative session. That report should be consulted for complementary detail on state finances and agency operations.

In addition to containing a copy of House Bill 2 as amended in the special session, this report consists of four major components:

- Budget Shortfall
- Legislative Budget Balancers
- Budget Outlook
- Agency Budgets

Budget Shortfall

This section provides a brief background of the conditions that precipitated a general fund budget shortfall, the general fund deficit that resulted, the legislative solution in the form of budget balancing actions, and the differences in the legislative actions from the executive proposal.

Legislative Budget Balancers

This section summarizes action taken by the legislature to balance the general fund budget. It provides a summary of the \$59 million in budget balancers by fiscal category and by legislative bill. It also provides a summary of expenditure reductions by program area (K-12, higher education, human services), and a summary of budget actions by agency in House Bill 2, House Bill 3 (pay plan), and the Governor's spending reductions.

Budget Outlook

This section provides an overview of some of the budget issues that may impact financial stability of the state general fund budget for the remainder of the 2003 biennium and an outlook for the 2005 biennium. It discusses the potential for further deterioration of state revenue collections and for supplemental appropriation requests. It also discusses the issue of structural imbalance of the general fund and the resulting shortfall that will occur in the 2005 biennium.

Agency Budgets

The Agency Budgets section is a detailed discussion of special session action as it impacts each agency. It provides a record of House Bill 2 and pay plan bill (HB 13) adjustments, other legislation impacting the agency, and a comparison to the executive recommendation. The section begins with a discussion of actions taken by the legislature with impacts on multiple agencies, including the pay plan appropriation reductions, the hiring freeze, and across-the-board reductions.

BUDGET SHORTFALL

BACKGROUND

For nearly a decade, states have enjoyed a strong state budget picture. Especially in recent years, states underestimated the strength of general fund revenue flows from a robust economy and a strong stock market. States were caught off guard when the national economy went into a recession in early 2002, further aggravated by the unpredictable events of September 11 and a receding stock market. States with sales taxes and large manufacturing/corporate sectors felt the impact first, while states like Montana, with a high dependence on income taxes, did not feel the full impact until calendar 2002. This mild recession on a national basis has hit states much harder than the more severe recession of the early 1990s, largely due to the increased share of state revenues from capital gains during an unprecedented period of stock market growth. While states anticipated a drop-off in capital gains revenues, the impact was far more severe than anticipated. Montana's state budget decline has been below the national average, yet there has been a dramatic decline in revenues that did not become fully apparent until the cycle of income tax revenue collections reached its peak in mid-2002.

In November 2001 and in a series of reports since then, this office reported to the legislature that Montana was experiencing a sharp decline in general fund revenues. On April 18 the Governor's Office formally announced concerns about a budget deficit and initiated proceedings to implement spending reductions in accordance with 17-7-140, MCA. On June 22, the Governor directed spending reductions of \$23 million and at the same time called for a special session of the legislature to deal with a budget deficit that had deteriorated further than the Governor felt could be dealt with under the limited authority of 17-7-140.

The following discussion provides pre-special session projections of the general fund deficit, a summary of legislative actions taken, and the revised projected ending fund balance for the 2003 biennium.

GENERAL FUND DEFICIT

The 57th Legislature adjourned the 2001 session with a 2003 biennium budget that provided for a projected general fund reserve of \$54 million (2.3 percent of biennial appropriations). The revenue estimates assumed a less robust growth pattern than immediate past biennia, but still a consistent growth. For the first several months following the 2001 session, state general fund revenues came in even stronger than projected in the revenue estimate resolution for fiscal 2001, resulting in \$62 million more than anticipated. Revenues then held steady in early fiscal 2002. In November 2001, the Legislative Fiscal Division reported a significant downturn in general fund revenues and in the last half of fiscal 2002, revenues dropped off from regular session estimates by \$153 million. Individual and corporate income taxes were the reason for the shortfall, dropping off by \$123 million and \$33 million respectively, while all other revenue components combined were up a net \$3 million. Although cushioned by the unexpected surplus in fiscal 2001, the revenue shortfall left a gap of \$90 million and placed the projected balance in a deficit situation.

The primary reasons for the decline in revenues are a sharp decline in net capital gains income due to the prolonged decline in equity markets, a sharp economic recession, and federal economic stimulus legislation that impacted state income tax revenues. These reasons are discussed in detail beginning on page 8 in the pre-session report Legislative Budget Analysis, August 2002 Special Session, dated July 23, 2002.

THE SOLUTION

Facing a projected ending fund balance of what ultimately turned out to be a negative \$42 million, the Governor directed statutory spending reductions of \$23 million, and called the legislature into special session to fill the remaining gap to achieve an acceptable ending fund balance reserve. The legislature adopted \$59 million in budget balancing actions, leaving an ending fund balance projection of \$40 million. Allowing a reserve of \$13 million for the 2003 session costs and anticipated supplementals, the projected ending fund balance is \$27 million. This is approximately \$1 million above the statutory minimum fund balance of \$26 million as specified in 17-7-140, MCA. The following table shows the deficit before executive and legislative action, and the resulting revised balance.

August 2002 Special Session General Fund - 2003 Biennium Projected Ending Fund Balance (millions)	
Projected Deficit Before Gov. Spending Reductions	\$ (42.0)
Gov. Spending Reductions, 17-7-140, MCA, June 2002	23.0
Projected Deficit Before Legislative Action	\$ (19.0)
Legislative Action*	
Expenditure Reductions	\$ 24.8
Other - Fund Switches, Fund Transfers, etc.	<u>34.1</u>
Total Adjustments to Increase GF Balance	58.9
Projected Ending Fund Balance After Legislative Action	39.9
Allowance for 2003 Session Costs/Supplementals (Anticipated Future Costs)	<u>(12.8)</u>
Projected Ending Fund Balance, with Reserve	\$ 27.1
Required Ending Fund Balance, by 17-7-140	\$ 26.1
* Excludes \$6.8 million of Gov. spending reductions adopted in HB2 - included in the \$23 million above	

As noted above, the projected ending fund balance of \$27 million includes a reserve for unanticipated costs, including \$5.6 million of supplemental costs. This reserve does not include all likely supplemental costs, and the ultimate ending fund balance is likely to be lower once all supplementals are taken into consideration. This issue is discussed further in the Budget Outlook section of this report, beginning on page 19.

Budget Balancers

The following table shows a breakdown of the types of budget balancers enacted in special session, resulting in \$59 million in general fund improvements. These budget balancers are explained in detail in the next section of this report.

Total Legislative Action - General Fund August 2002 Special Session (millions)	
Redirect Revenues to General Fund	\$ 2.3
Additional or Accelerated Revenue Collections	9.6
Funding Switch to Replace General Fund	18.5
Fund Balance to General Fund	4.2
Expenditure Reductions/Increases	24.8
Feed Bill - Special Session	(0.5)
 Total Legislative Action (Excluding 17-7-140 red.)	 \$ 58.9
Adopt Gov. 17-7-140 Reduction (elected officials/MUS)	6.8
Total Legislative Action with HB2 17-7-140 reductions	\$ 65.7

The budget balancers include the revenue estimates adopted by the legislature in HJR 1. Appendix A includes tables that show the revenue estimates by source of revenue, revenue legislation passed in the special session, and the revised revenue estimates by source after the August special session, including legislation.

Differences from Executive Proposal

The Governor called the legislature into special session to resolve the general fund budget shortfall, and submitted a budget plan for \$51.5 million in fund balance increases, which included \$45.3 million in budget balancers plus \$6.2 million in fund transfers that were part of the original proposals of the Governor under 17-7-140 spending reductions but required legislative authorization. The plan included only a \$10 million reduction in state agency operations, primarily in higher education and personal services reductions. The plan proposed reductions to K-12 education of \$10 million, and reduced payments and grants to local governments and other groups. Nearly one-half of the proposals were one-time adjustments, including funding switches, fund balance transfers, and additional revenue collections.

The legislature adopted the majority of the executive plan as proposed. The most significant differences were abandonment of a proposal for a state employee furlough and reducing the proposed reduction in K-12 flexible spending funds from \$4.6 million to \$0.5 million. In addition, the legislature adopted \$7.5 million more in budget balancers than the executive proposed, primarily due to fiscal 2002 year-end closing adjustments that were identified early in the special session. To fund these differences, the legislature adopted \$7.3 million in across-the-board agency reductions (equipment, office supplies, and 1 percent of all appropriations) and transferred \$4.0 million from the state worker's compensation old fund. Differences from the executive proposal are discussed in detail by agency in the Agency Budgets section of this report.

LEGISLATIVE BUDGET BALANCERS

INTRODUCTION

As discussed in the previous section, the legislature enacted \$59 million of budget balancers (excluding \$6.8 million of executive spending reductions adopted in HB 2) to bring the general fund from a deficit projection for the 2003 biennium to a positive ending fund balance of \$27.1 million. This section summarizes the actions taken by the legislature to balance the general fund budget. It summarizes the actions in four sections:

- 1) Budget Balancers by Fiscal Category, which lists all budget balancers by one of several categories
- 2) Expenditure Reductions by Program Area, which focuses on the major program areas with the most significant budget reductions (K-12 education, higher education, and human services)
- 3) Budget Actions by Agency, which is a listing by agency of the HB 2 and HB 13 (pay plan bill from the 2001 regular session) appropriations action, and the Governor's spending reductions
- 4) Budget Balancers by Bill, which summarizes all bills enacted in special session impacting either revenues or expenditures.

BUDGET BALANCERS BY FISCAL CATEGORY

The legislature improved the general fund projected balance by enacting \$59 million in budget balancers. These included \$24.8 million in actual expenditure reductions and \$34.1 million in other actions, such as funding switches, fund balance transfers, and additional revenue collections. The following table shows each budget balancer by category of budget balancers including the bill number and the amount for each action taken. The following narrative briefly describes the categories and the significant actions included in the category. Additional information on each bill shown in the table can be found beginning on page 13 of this report.

- 1) Redirect Revenues to the General Fund – In this category are those actions taken by the legislature that take revenues currently directed toward a non-general fund account, and direct them to the general fund on a temporary basis. For example, coal severance tax revenues going to the parks and arts trusts will be diverted to the general fund, as will metal mines and oil and gas severance taxes currently going to environment-related accounts. HB 10 was the primary vehicle for this type of action. Only those actions that have limited or no immediate impact on agency spending are included. Other revenue diversions with an immediate impact on funds available for expenditure are included in the “Expenditure Reductions/Increases” category.
- 2) Additional or Accelerated Revenue Collections – This category includes actions that increase revenue collections without an increase in taxation rates. For example, the lottery will reduce expenditures, which will increase revenues to the general fund through higher reversions. Certain collections, such as metal mines tax and the endowment tax credit, will be accelerated. Additional compliance auditors in the Department of Revenue are expected to increase collections of revenue already owed.
- 3) Funding Switch to Replace General Fund – This category includes all action where funds in non-general fund accounts are used to replace expenditures currently funded with general fund. In this category are replacement of: 1) Motor Vehicle Division expenditures with highways state special revenue account; 2) county payments with accommodations tax; 3) several functions with state fund “old fund” balance; 4) environmental-based activities in the Department of Natural Resources and Conservation with RIT trust balance; and 5) several functions with Employment Security Account funds. These funding switches utilize fund balances and are consequently of a one-time-only nature.
- 4) Fund Balance to General Fund – Several fund balances were deposited directly into the general fund, including \$5.7 million from highways special revenue funds originally intended to replace vehicle taxes diverted in HB 124, and \$1 million in orphan share funds. Because they utilize fund balance, they are one-time-only.
- 5) Expenditures Reductions/Increases – The largest category, listed here are all the actions that will result in fewer funds to agencies or other governments in fiscal 2003. As shown in the detailed listing, any increases in spending are also included. The larger reductions are across-the-board reductions (\$7.3 million), education reductions (\$7.5 million, excluding across-the-board reductions), and pay plan/hiring freeze reductions (\$6.2 million). As stated earlier, a limited number of the specific reductions are the result of revenue diversions to the general fund -- coal

tax shared account and the Long Range Building Program -- due to diversions of coal severance tax proceeds. These reductions are summarized by major program area in the next section, page 9.

- 6) Feed Bill – HB 1 appropriates funds for the operations of the August 2002 special session.

For a further discussion of the individual actions within each category, see the “Other Legislation” section of this report for the individual bills, and the “Agency Budgets” section for impacts on individual agencies.

Total Legislative Action - General Fund August 2002 Special Session (millions)			
	Bill No.	Amount	Totals
Redirect Revenues to General Fund*			
Parks Trust	HB 10	\$ 408,000	
Arts Trust	HB 10	203,000	
Metal Mines	HB 10	383,310	
Oil and Gas Severance	HB 10	1,515,501	
Coal Tax Shared Accounts	HB 2	(241,942)	\$ 2,267,869
Additional or Accelerated Revenue Collections			
Fines	HB 18	\$ 69,300	
Metal Mines Tax Collection Acceleration	SB 30	1,827,000	
Endowment Tax Credit	SB 15	1,839,000	
Indirect Costs	HB 21	1,507,000	
Reduce Interentity Loans	HB 16	856,000	
Revenue Estimate Revisions (to LFD #s)	HJR 1	270,000	
Mineral Leasing	HB 11	1,197,000	
Lottery Reduced Expenditures	HB 2	190,000	
Additional Compliance Auditors -Department of Revenue	HB 2	1,862,000	9,617,300
Funding Switch to Replace General Fund			
Highways State Special Revenue to Motor Vehicle Division	HB 2	\$ 6,540,751	
Employment Security Funds	HB 2	3,938,349	
RIT Trust Balance	HB 2	1,000,000	
Alcohol Tax	HB 2	1,000,000	
Cultural and Aesthetics Grants	HB 8	198,575	
Accommodations Tax to Counties	HB 18	1,700,000	
State Fund to General Fund	SB 19	1,900,000	
State Fund to Flex Fund, Replaces General Fund	SB 19	2,100,000	
Universal Access Fund	SB 26	66,000	
MTAP to MT School for Deaf and Blind	SB 27	56,995	18,500,670
Fund Balance to General Fund			
Highways State Special Non-Budgeted Transfer	HB 5	\$ 2,841,961	
Orphan Share	HB 9	1,000,000	
Residual Equity Transfer	HB 13	400,000	4,241,961
Expenditure Reductions/Increases			
Judiciary Judges Staff	HB 2	\$ (152,137)	
School for Deaf & Blind - Restore reductions	HB 2	(81,995)	
Amber Alert Security	HB 2	(75,000)	
PHHS - Maintain Elderly Community Services	HB 2	(97,191)	
Additional Auditors and Replace Funding	HB 2	(928,784)	
Consensus Council	HB 2	37,500	
K-12 Flex Fund Reduction**	HB 2	516,000	
Higher Education Reductions	HB 2	2,129,326	
1 Percent Across-the-Board Reduction	HB 2	3,885,306	
Equipment Reduction	HB 2	2,809,566	
Reduction in Supplies	HB 2	607,528	
HB 13 Pay Plan	HB 3	4,831,983	
Timber Funds - K-12**	HB 4	2,922,000	
Personal Car Reimbursement	HB 6	400,000	
Long Range Building Program**	HB 10	644,000	
Coal Tax Shared**	HB 10	717,684	
Hiring Freeze	HB 12	1,400,000	
Higher Education - 6 Mil Levy Adjustment**	HB 18	209,912	
District Courts and County Reimbursement	HB 18	201,112	
K-12 Public Schools Reductions	HB 18	2,256,656	
Economic Development Reductions			
Research/Commercialization	HB 5	1,685,000	
Economic Development	HB 10	600,000	
Growth Through Agriculture	HB 10	325,000	24,843,466
Feed Bill - Special Session	HB 1	\$ (497,666)	\$ (497,666)
Total Legislative Action (Excluding 17-7-140 reductions)			\$ 58,973,600
Adopt Governor 17-7-140 Reduction (elected officials/MUS)	HB 2	\$ 6,767,138	6,767,138
Total Legislative Action with HB2 17-7-140 reductions			\$ 65,740,738
* Will result in long-term expenditure reductions.			
** Redirects Revenue to Gen. Fund, results in expenditure reduction			

EXPENDITURE REDUCTIONS BY PROGRAM AREA

The following section shows the impacts of the \$24.8 million in true expenditure reductions (one of the categories in the previous table) by major program area of state government. This section does not include fund switches, balance transfers, or other categories not reducing expenditures. The program areas receiving the largest reductions were K-12 education, higher education, human services, and economic development. This section does not include spending reductions implemented by the Governor in June. The following table shows the reductions by program, and the narrative following the table provides additional detail. For further detail in these areas, see the "Agency Budgets" section of this report.

Special Session Legislative Action Expenditure Reductions by Program Area			
Agency	Bill #	Action	Fiscal Impact General Fund
K - 12 Education/OPI			
	HB 2*	K-12 Flex Fund Reduction	\$ (516,000)
	HB 4*	K-12 Timber Funds	(2,922,000)
	HB 18	K-12 Public School Reduction	(2,256,656)
	HB 2	OPI-Across-the-Board Reductions	(29,171)
	HB 3	OPI-Pay Plan Reduction	(37,510)
Total Reduction K-12 Education/OPI			\$ (5,761,337)
Montana University System			
	HB 2	Across-the-Board Reductions	\$ (3,414,700)
	HB 2	General Reduction	(2,129,326)
	HB 3	GF Pay Plan Reduction	(1,751,810)
	HB 10	Reduce Long Range Bldg Plan projects	(284,000)
	HB 18*	Eliminate Distribution to 6 mill levy	(209,912)
Total Reduction Montana University System			\$ (7,789,748)
Public Health and Human Services			
	HB 2	Across-the-Board Reductions	\$ (1,815,056)
	HB 2	Maintain Elderly Community Services	97,191
	HB 3	GF Pay Plan Reduction	<u>(820,707)</u>
Total Reduction Human Services			\$ (2,538,572)
Economic Development			
	HB 5	Research/Commercialization	\$ (1,685,000)
	HB 10	Economic Development	(600,000)
	HB 10	Growth Through Agriculture	(325,000)
Total Reduction Economic Development			\$ (2,610,000)
Other Reductions			
	HB 2	Across-the Board Reductions	\$ (2,043,473)
	HB 2	Hiring Freeze, All Agencies	(1,400,000)
	HB 2	Other Reductions (net)	(478,380)
	HB 3	GF Pay Plan Reduction	<u>(2,221,956)</u>
Total Other Reductions			\$ (6,143,809)
Total Expenditure Reductions			<u>\$ (24,843,466)</u>
*Redirects revenue to General Fund, results in expenditure reduction			

K-12 Education/OPI

Secondary education was reduced by \$5.8 million, of which all but \$66,700 was for distribution to schools.

- o The schools flex fund was reduced by \$516,000 (plus an additional \$184,000 in the Governor's spending reductions in June). There is \$4.1 million remaining in the fund for distribution to schools and \$200,000 for student testing.
- o House Bill 4 suspended the timber for technology program for fiscal 2003 and 2004. Timber revenues on school lands will be diverted into the new guarantee account, and the general fund will achieve a savings.
- o House Bill 18 reduced block grants (HB 124, the "Big Bill) to districts and to the countywide school retirement and transportation accounts, to correct a formula calculation in HB 124.
- o Across-the-board reductions for equipment and office supplies, and the pay plan reduction, were \$66,681 for the Office of Public Instruction.

Montana University System

Higher education was reduced by \$7.8 million, in addition to reductions of \$5.1 million ordered by the Governor in June and adopted by the legislature in HB 2 during the special session.

- o The university system's share of across-the-board reductions (1 percent general fund, equipment, and office supplies) was \$3.4 million.
- o The university system received a general reduction to the lump sum appropriation of \$2.1 million, with a statement of legislative intent that intercollegiate athletics be reduced.
- o The university system share of the reduction in funding for the fiscal 2003 pay plan increase was \$1.8 million.
- o House Bill 10 revised allocation of coal severance tax receipts for the Long Range Building Program from 12 to 10 percent, impacting two university system projects by \$284,000.
- o House Bill 18 terminated the reimbursement of lost business equipment tax revenue to the six mill levy, for a \$209,000 reduction in fiscal 2003.

Public Health and Human Services

The only reductions in the special session for human services programs were across-the-board and pay plan reductions of \$2.6 million, but these were in addition to \$9.6 million in Governor's spending reductions in June. The legislature increased funding to maintain senior and physically disabled home and community based services for persons eligible for Medicaid.

Economic Development

Economic development programs were reduced by \$2.6 million.

- o House Bill 5 eliminates the transfer of \$485,000 to the research and commercialization account as included in the Governor's original 17-7-140, MCA spending reduction plan, and reduces the transfer an additional \$1.2 million in fiscal 2003. The \$1.2 million transfer is suspended for each year of the 2005 biennium as well.
- o House Bill 10 reduced the statutory allocation of revenue from the coal severance tax to the Office of Economic Development by 50 percent, a reduction of \$175,000 (in addition to \$127,500 removed in the Governor's spending reductions in June). It also reduced the Certified Communities Program by \$425,000 and the Growth Through Agriculture Program by \$325,000.

Other Reductions

The across-the-board and pay plan reductions for all other program areas other than education and human services were \$2.0 million and \$2.2 million respectively. The hiring freeze is expected to save \$1.4 million in all agencies. All other reductions (net of some increases) were less than \$500,000.

BUDGET ACTIONS BY AGENCY

The following figure shows the impact of budget balancing measures on individual agencies. Please note three things about the table:

- 1) The table only shows impacts reflected in HB 2 and HB 13 (the pay plan bill adopted during the 2001 regular legislative session). Therefore, impacts not reflected in reductions or increases in an individual agency's appropriation or ability to spend are not included in the table.
- 2) The table shows general fund only. In some instances, the reduction in general fund is not reflective of an overall reduction in an agency's ability to spend, as the general fund may have been replaced with other funding sources. For example, the Departments of Public Health and Human Services, Military Affairs, and Labor and Industry; and the Montana Arts Council and Montana Historical Society, had reduced general fund partially replaced with other funding sources. For a complete discussion and tables showing the impact on total spending authority, see the individual agency narratives in the "Agency Budgets" section of this report.
- 3) The table also shows the impacts of the Governor's spending reductions ordered under the authority of 17-7-140, MCA. These reductions are not reductions in appropriations authority, but are listed to show the total impact on an agency's ability to expend funds as a result of all fiscal 2003 budget balancing actions. Total Governor's spending reductions were \$23 million, but \$6.8 million were adopted in HB 2 for elected officials and the Board of Regents.

Impact by Agency - Appropriation Reductions and Governor's Spending Reductions
General Fund - HB 2 and HB 13 Only
Fiscal 2003

Agency	Original General Fund Appropriation*	Legislative Reductions**	Adjusted General Fund Appropriation	Governor's *** Spending Reductions	Total General Fund
Legislative Branch	\$ 7,860,788	\$ (235,258)	\$ 7,625,530	\$ (350,000)	\$ 7,275,530
Consumer Counsel	-	-	-	-	-
Judiciary	9,890,765	(7,135)	9,883,630	(365,746)	9,517,884
Chiropractic Legal Panel	253,634	-	253,634	-	253,634
Governor's Office	4,465,087	(137,586)	4,327,501	(491,329)	3,836,172
Commissioner of Political Practices	359,417	(9,225)	350,192	(16,850)	333,342
State Auditor****	336,923	(16,314)	320,609	-	320,609
Transportation	-	-	-	-	-
Revenue	29,402,233	1,085	29,403,318	(757,688)	28,645,630
Administration	4,476,739	(100,232)	4,376,507	(293,252)	4,083,255
Appellate Defender	187,882	(4,122)	183,760	(6,576)	177,184
DPHHS	277,206,875	(5,503,771)	271,703,104	(9,601,759)	262,101,345
DFWP	281,817	(4,326)	277,491	(24,304)	253,187
DEQ	4,070,797	(89,756)	3,981,041	(252,691)	3,728,350
Livestock	639,319	(12,984)	626,335	(39,180)	587,155
DNRC	17,259,334	(1,597,744)	15,661,590	(166,557)	15,495,033
Agriculture	824,167	(27,945)	796,222	(88,600)	707,622
Commerce	1,834,055	(40,658)	1,793,397	(573,453)	1,219,944
Crime Control	1,844,149	(29,677)	1,814,472	(184,415)	1,630,057
Justice****	24,332,445	(7,451,568)	16,880,877	-	16,880,877
Public Service Regulation	-	-	-	-	-
Corrections	100,300,414	(906,345)	99,394,069	(2,147,533)	97,246,536
Labor & Industry	2,088,192	(918,459)	1,169,733	(140,193)	1,029,540
Military Affairs	4,300,362	(1,162,844)	3,137,518	(172,939)	2,964,579
OPI****	506,849,250	(8,915,747)	497,933,503	-	497,933,503
Board of Public Education	177,735	(3,761)	173,974	(17,774)	156,200
School for the Deaf & Blind	3,653,186	(22,645)	3,630,541	(130,638)	3,499,903
Arts Council	324,365	(7,895)	316,470	(54,793)	261,677
Library Commission	1,779,828	(35,450)	1,744,378	(87,811)	1,656,567
Historical Society	1,893,434	(43,721)	1,849,713	(109,819)	1,739,894
Montana University System****	146,994,457	(12,438,013)	134,556,444	(9,964)	134,546,480
Total	\$ 1,153,887,649	\$ (39,722,096)	\$ 1,114,165,553	\$ (16,083,864)	\$ 1,098,081,689

*HB 2 and HB 13

**HB 2 and HB 3 (HB 13 from regular session)

***This column doesn't include \$6.8 million of Gov. reductions for elected officials that were incorporated into HB 2. Legis. Branch/Judiciary are voluntary reductions. The figures by agency are based upon actual reductions by agency on SABHRS. Total reduction taken by the Governor is

****Governor's spending reduction included in HB 2 reduction

The reduction to OPI does not include a funding switch of \$48.701 million as a result of the passage of HB 7, which creates a state special guarantee account.

BUDGET BALANCERS BY BILL

The following table shows the budget balancers by legislative bill, followed by a short description of each piece of legislation.

Legislation with Fiscal Impact Fiscal 2003		
Bill No.	Description	Impact to General Fund
HJR 1	Revenue Estimate Resolution	\$ 270,000
HB 1	Feed Bill	(497,666)
HB 2	General Appropriations Act (including Governor's 17-7-140 actions)	29,706,415
HB 3	State Employee Pay Plan 20 Percent Reduction	4,831,983
HB 4	Reallocate Certain School Timber Money	2,922,000
HB 5	Reduce Transfers to Transportation and Research/Commercialization	4,526,961
HB 6	Change State Vehicle Mileage Allowance	400,000
HB 7	Reallocate Dedicated Public School Revenue (see narrative)	n/a
HB 8	Switch Funding for Cultural and Aesthetic Grants to Bed Tax	198,575
HB 9	Revise Resource Indemnity Trust Transfers and Interest Distribution	1,000,000
HB 10	Revise Allocation of Coal Severance Tax	4,796,495
HB 11	Revise Amount of Federal Mineral Leasing Funds	1,197,000
HB 12	State Employee Hiring Freeze	1,400,000
HB 13	Debt Collection Internal Service Fund Residual Transfer	400,000
HB 16	Maximize General Fund Interest by Limiting Interentity Loans	856,000
HB 18	Revise and Clarify State/Local Finance - HB 124 Fixes	4,436,980
HB 21	Require Full Recovery of Indirect Costs from Grants	1,507,000
SB 1	Changing Funding of Alcohol and Chemical Dependency Programs ⁽¹⁾	n/a
SB 6	Limit Special TANF Authority/Appropriation from 2001 Session ⁽¹⁾	n/a
SB 15	Decrease the Qualified Endowment Tax Credit	1,839,000
SB 19	Fund Transfer from State Fund to General Fund and Flex Fund	4,000,000
SB 26	Transfer Universal Access Funds (Public Service Commission) to General Fund	66,000
SB 27	Transfer from Telecommunications Services Account to School for Deaf and Blind	56,995
SB 30	Revise Time of Payment of Metal Mines License Tax	<u>1,827,000</u>
Total Legislation With Fiscal Impact		\$ 65,740,738
HB 2	Exclude: Gov. 17-7-140 Reductions included in HB 2	<u>(6,767,138)</u>
Legislation With Fiscal Impact, Excluding Gov. 17-7-140 Reductions		\$ 58,973,600
Note: ⁽¹⁾ Fiscal actions occurred in HB 2		

HJR 1 is the revenue estimate resolution. The bill as introduced included the Legislative Fiscal Division revenue projections, and was amended by a net \$270,000 prior to adoption. Appendix B includes a detailed summary of the revenue estimates by source contained in HJR 1.

HB 1 appropriated \$497,666 general fund for the costs associated with holding a special session.

HB 2 is the general appropriations act from the 2001 legislative session, which was amended to directly reduce general fund appropriations by nearly \$30 million, including the Governor's elected officials portion of the 17-7-140 reductions of \$6.8 million. The largest adjustments were for across-the-board reductions in agency budgets (for office supplies, equipment, and a general 1 percent total budget reduction), and fund transfers from the highways special revenue account and the employment security account to replace general fund appropriations. There were other indirect HB 2 general fund impacts, resulting in a net general fund impact of \$29.7 million. The following table shows the general fund amendments to HB 2.

House Bill 2 Amendments General Fund Only August 2002 Special Session (millions)		
<hr/>		
Increased General Fund Appropriations		
Support Staff for New Judges	\$	(0.152)
MSDB - Partial restore 17-7-140 reductions		(0.025)
MSDB - MTAP Transfer to General Fund - restore reductions		(0.057)
Amber Alert System - Dept. Justice		(0.075)
Maintain Elderly Community Services		(0.097)
Additional Revenue Audit and Compliance (\$1.86 mil. Rev. gain)		(0.929)
General Fund Savings (Reductions/Fund Transfers etal.)		
Accommodations Tax Fund Switch for certain programs (State Sp)*		---
Governor's Consensus Council		0.038
RIT - Fund Switch (Weed Fund etal.)		1.000
Motor Vehicle Fund Division Fund Switch		6.541
Employment Security Account Fund Switch		3.938
Montana University System		2.129
Across the Board Reductions - Office Supplies		0.607
1% Across the Board Reduction (Excl. Corr., PHHS-partial)		3.885
2/3 Reduction in Fiscal 2003 Equipment Appropriation		2.810
Flex Fund K-12 - Reduction in HB 2**		2.616
Alcohol Tax Fund Switch		1.000
Adopt Governor's 17-7-140 reductions for elected officials/MUS		6.767
Reduce Low-Income Housing (SB6) - \$2.765 million State Special		---
Restore Weed Funding (State Special Revenue, \$300,000)		---
Total HB 2 Direct General Fund Adjustments (General Fund Net Savings)	\$	29.996
Other Indirect HB 2 Adjustments		
State Fund Transfer to K-12 Flex Fund, Replaces General Fund	\$	(2.100)
Coal Tax Shared Accounts	\$	(0.242)
Lottery Reduced Expenditures (increases GF revenues)	\$	0.190
Revenue Gain from Additional Compliance Auditors, Dept. of Rev.	\$	1.862
Net HB 2 Impact (General Fund Net Savings)	\$	29.706
Positive number means increase in gen. fund balance, negative number means gen. fund cost		
* Dept. FWP \$0.258, Museum of Rockies \$0.515, Arts Council \$0.057, Library Comm. \$0.842		
** Partially offset by \$2.1 million state special transfer from state fund (SB19), shown as indirect adjustments		

HB 3 reduces the fiscal 2003 general fund appropriation to implement the state pay plan by 20 percent, and reduces the contingency appropriations, for a total general fund reduction of \$4.8 million. For a further discussion, see the “Pay Plan Reduction” discussion on page ____ of this report.

HB 4 temporarily diverts school lands timber revenue in excess of 18 million board feet to a new state special revenue fund called the guarantee fund. Under previous law, timber revenue was deposited in the state special timber for technology account and distributed to school districts in the following year. HB 4 diverts fiscal 2002 and 2003 timber revenue into the guarantee account and is to be used to pay for a portion of BASE aid in fiscal 2003. Distributions to school districts for technology purchases will be suspended for fiscal 2003 and 2004. The amount that will be deposited in the guarantee account in fiscal 2003 is expected to be \$2.9 million.

HB 5 reduces or eliminates transfers from the general fund: 1) \$5.7 million to the highways state special revenue account originally slated to replace vehicle taxes diverted in HB 124 passed in the 2001 legislative session; and 2) \$485,000 to the research and commercialization account. Both actions complete reductions proposed by the Governor under the authority of 17-7-140, MCA. In addition, HB 5 reduces the transfers to the research and commercialization account by \$1.2 million each year through fiscal 2005. Although authorized in HB 5, \$2.8 million of the highways state special revenue transfer was for fiscal 2002, which is not included in the totals for legislative action, since the transfer was included in the beginning fund balance for fiscal 2003.

HB 6 requires that any state employee or officer traveling on state business be paid 52 percent of the Internal Revenue Service (IRS) low mileage rate for using a personal vehicle if a state car is available.¹ If a state car is not available, the employee is entitled to the mileage prescribed under state law. Estimated savings are one-half of the total personal car reimbursements in fiscal 2002, or \$400,000 general fund per year.

HB 7 creates a new state special guarantee account that will receive deposits of interest and income from school lands, as well as timber revenue previously used to pay for school district technology purchases. The guarantee account will be used to pay for a portion of BASE aid in fiscal 2003. The account will receive \$48.8 million in interest and income and \$2.9 million in timber revenue in fiscal 2003. Revenue to the general fund will be reduced by \$48.8 million in fiscal 2003.

HB 8 switches \$198,575 in funding for cultural and aesthetic grants to the Montana Arts Council (usually appropriated in HB 9 during regular legislative session) from general fund to accommodations tax in fiscal 2003.

HB 9 makes several adjustments. Generally and in concert with portions of HB 10, the overall impact and purpose is to:

- 1) Divert RIT proceeds to the general fund
- 2) Replace general fund with RIT related fund balances in the Department of Natural Resources and Conservation
- 3) Adjust grants and interest allocations to “replenish” the reclamation and development account

¹ The IRS rate is \$0.365 per mile for the first 1,000 miles and \$0.03 less for all additional miles within a given calendar month. The state motor pool rate depends upon the type of vehicle requested. The rate for a mid-size sedan is \$0.054 per mile, plus \$1.643 per hour (with a minimum of 8 hours).

Specifically, the bill:

- 1) Transfers up to \$1,000,000 of fund balance from the orphan share account to the general fund
- 2) Reduces the transfer of excess resource indemnity trust (RIT) fund balance for weed eradication from \$500,000 to \$300,000
- 3) Transfers \$1.0 million of excess RIT fund balance to the reclamation and development grants account. HB 2 was then adjusted to replace a similar amount of general fund appropriations in the Department of Natural Resources and Conservation with reclamation and development grants account funds.
- 4) Reduces grants funded with reclamation and development grants originally funded in the 1997 legislative session by \$466,752
- 5) Reduces 2003 biennium future fisheries grants by \$150,000 and reclamation and development grants by \$300,000
- 6) Redirects RIT interest income among several accounts

HB 10 makes several adjustments:

- 1) Diverts metal mines and oil and gas severance tax proceeds to the general fund (\$1.9 million)
- 2) Diverts coal severance tax proceeds in fiscal 2003 to the general fund (\$1.97 million):
 - a) The Long Range Building Program (12 percent to 10 percent)
 - b) The shared coal tax fund (8.36 percent to 6.01 percent – HB 2 state special revenue appropriations were adjusted to account for the reduced income)
 - c) The parks trust (entire 1.27 percent). Interest lost to the trust is anticipated to total about \$14,000 in fiscal 2003
 - d) The arts trust (entire 0.63 percent). Interest lost to the trust is anticipated to total about \$6,000 in fiscal 2003
- 3) Reduces economic development programs in fiscal 2003:
 - e) Certified communities (\$425,000)
 - f) Growth through Agriculture (\$325,000)
 - g) Governor's Office of Economic Development (\$175,000)
 - h) Reduces certain capital projects established in the 1999 and 2001 legislative sessions

HB 11 as enacted by House Bill 226 in the 2001 legislative session, revenues from U.S. mineral royalties received in fiscal 2003 in excess of \$20,474,000 were to be distributed to eligible counties. Since this limit was the amount of the HJR 2 revenue estimate, no excess money was anticipated. House Bill 11 increased this limit to \$21,671,000 which, when coupled with a new revenue estimate of \$21,738,000, will result in \$1,197,000 of general fund revenue (that would have been distributed to eligible counties before House Bill 11) and a \$67,000 distribution to eligible counties.

HB 12 imposes a hiring freeze in fiscal 2003 on all agencies of state government, with the exception of the Montana University System. An agency may fill a position only with the approval, in writing, of the agency's approving authority² to "...protect the public health, safety, and welfare of the citizens of the state and to avoid significant disruptions to critical state services." Expected savings total \$1.4 million general fund and are assumed as an increase in the anticipated general fund balance.

² The Governor or their designated representative for the Executive Branch, the Board of Regents for the Montana University System, the Supreme Court for the Judiciary, the Speaker of the House for the House of Representatives, the President of the Senate for the Senate, the Legislative Finance Committee for the Legislative Fiscal Division, the Legislative Council for the Legislative Services Division, and the Legislative Audit Committee for the Legislative Audit Division.

HB 13 transfers \$400,000 in excess funds from the Department of Revenue debt collection internal service fund to the general fund. The Governor had recommended this action as part of 17-7-140 spending reductions, but the transfer required legislative action to complete.

HB 16 requires agencies to certify to the Department of Administration that they have billed the federal government or other third parties for their share of costs charged against a fund prior to seeking a general fund loan for that fund. Estimated general fund interest saved is \$856,000 in fiscal 2003. The Department of Administration received an additional 1.0 FTE for financial management in the fiscal 2001 legislative session. Consequently, it will be difficult to gauge the actual savings as a result of this bill.

HB 18 transfers \$1.7 million in accommodations tax reserves from the state special accommodations tax account to the general fund in fiscal 2003 and increases general fund revenue by \$69,300 by eliminating the 50 percent distribution of gambling fines and penalties (23-5-123, MCA) to counties' general fund, beginning in fiscal 2003. The bill also reduces block grants to school districts and to the countywide school retirement and transportation accounts. For a further discussion, see the Office of Public Instruction narrative in the "Agency Budgets" section of this report.

HB 21 requires that agencies not waive their rights to collect indirect costs from the federal government or other third parties when available. The estimated additional indirect cost collections to the general fund are \$1.507 million.

SB 1 temporarily allows the use of state special revenue alcohol tax funds statutorily appropriated to county chemical dependency programs to be used as state matching funds for Medicaid services in addition to chemical dependency and alcoholism. This bill was implemented in HB 2 by a \$1 million general fund reduction and a \$1 million increase in alcohol tax funds to be used as Medicaid match for mental health services. The fiscal actions occurred in HB 2.

SB 6 revised the allocation of TANF funds available to the Board of Housing for the Low-Income Revolving Loan Account from \$3.4 million to \$700,000. The fiscal actions occurred in HB 2.

SB 15 temporarily reduces the income and corporate tax credit for gifts to charitable endowments and also temporarily increases the credit for a similar period of time. In fiscal 2003, it is estimated that income tax revenues will increase by \$1.839 million, although the estimate is highly uncertain. No estimate of the revenue decline in fiscal 2004 and 2005 is available.

SB 19 transfers a total of \$4.0 million from the state workers' compensation fund for four uses:

- 1) \$2.1 million to the K-12 flex fund for distribution to school districts. Along with an increase of \$2.0 million from the general fund, this action increases the total appropriation in the fund from the Governor's recommended \$200,000 to \$4.3 million.
- 2) \$550,000 to the Department of Public Health and Human Services to offset a portion of earlier reductions
- 3) \$79,326 to the State Library Commission to offset reductions in the equipment budget
- 4) \$1,270,674 to offset reductions in the Montana University System

The bill also mandates a study of the structure of the state fund prior to the 2003 legislative session, with membership from the legislature, the State Auditor's Office, and insurers.

SB 26 transfers 10 percent of the fund balance in the universal access fund administered by the Public Service Commission to the general fund, and 90 percent to a state special revenue account for use by the Department of Public Health and Human Services. Transfer to the general fund totals almost \$66,000. State special revenue was appropriated in HB 2 to the Department of Public Health and Human Services for two uses: \$350,000 to reduce the Medicaid co-pay, and \$258,736 to maintain mental health day treatment for children.

SB 27 revises the laws dictating uses of the account used to provide funds to improve communications access of persons with disabilities to include the Montana School for the Deaf and Blind (MSDB), and transfers \$56,995 of the fund balance to the general fund for use by MSDB. A corresponding amount was added to the MSDB appropriation in HB 2.

SB 30 provides for a one-time accelerated collection of metalliferous mines taxes by providing for semi-annual rather than annual payments. In coordination with House Bill 10 (see above), Senate Bill 30 is expected to result in a fiscal 2003 increase in general fund of \$1,827,150 plus increases to the hard rock mining impact account (\$70,275), hard rock mining reclamation debt service account (\$238,935), and statutorily appropriated distributions to counties (\$674,640).

BUDGET OUTLOOK

In a series of reports by the LFD on the General Fund Status since November 2001, this office has reported that Montana faced not only a significant 2003 biennium deficit, but an even more serious long-term structural imbalance between ongoing expenditures and state revenues. Although the budget was balanced in the special session, there are a number of uncertainties that can affect the projections with over ten months left to go in the biennium. And a flat revenue base combined with ever increasing expenditures further exacerbates the structural imbalance problem for the long term. The purpose of this section is to provide an overview of some of the budget issues that may impact financial stability of the state budget for the remainder of this biennium and the 2005 biennium.

REMAINDER OF 2003 BIENNIUM

The 57th Legislature rebalanced the 2003 biennium general fund budget during the August 2002 Special Session, leaving a projected ending fund balance reserve of \$27.1 million, which is 2.1 percent of fiscal 2003 appropriations. This balance includes a reserve for anticipated costs of \$7.2 million for the 2003 legislative session and \$5.6 million for supplementals. The projected balance is just \$1.0 million over the minimum general fund balance calculated in accordance with 17-7-140, MCA. This leaves no margin for any downturn in projections during the remaining ten months of this biennium if the requirements of 17-7-140 are to be strictly followed (it requires the executive to implement spending reductions if general fund projections drop below \$26.1 million). It should be noted, however, that from a risk standpoint, the size of a required reserve should diminish as the length of time to the end of the projected period becomes less. It is also worthy to note that the legislature will convene in regular session in January 2003, 6 months before the end of the biennium, and could act if necessary to deal with a further diminished fund balance projection. However, the further into the fiscal year that it gets, the fewer options there are to consider.

Factors that May affect Projected Deficits

There are a number of factors that could affect the projected ending general fund balance, including wildfire costs and other supplementals, as well as further deterioration of the state revenue base as a result of economic issues.

Supplemental Appropriations

As shown in the table, the legislature included a reserve for anticipated supplementals of \$5.6 million in the projected ending fund balance adopted in special session. This total includes \$5.3 million for fiscal 2002 Spring wildfires and \$0.3 million for Department of Justice litigation costs. These are supplemental requests that the executive has stated they will request in the 2003 session. The executive has also stated it will request a supplemental appropriation for Public Health and Human Services, and reimbursement for the cost of fiscal 2003 wildfires.

- DPHHS Fiscal 2002 Cost Over-run: The executive submitted a report to the Legislative Finance Committee in June 2001 stating they would transfer \$3.9 million from fiscal 2003 to fiscal 2002 due to a funding shortfall based on PHHS projections. The report also stated that the full amount would be requested as a supplemental appropriation for fiscal 2003. A plan for mitigation of the costs was not submitted.
- Wildfire Costs, Fiscal 2003: The projections do not include an estimate for wildfire suppression costs for the 2002 summer fire season (fiscal 2003), even though some costs have already been incurred, and a supplemental will clearly be required. An average annual fire suppression cost is

\$7.3 million, which is a conservative estimate in view of the improved yet still existing drought conditions the state is experiencing. This is a highly probable cost that will occur in fiscal 2003.

Since no estimate is included in the legislative projections for the two additional projected supplementals, the final ending fund balance can be expected to be as much as \$11.2 million less, or down to \$15.9 million.

Supplementals Legislative Reserve vs. Other Potential Supplementals (millions)				
	Legislative Reserve	Potential Supplementals	Difference	
Spring Wildfires (fiscal 2002)	\$ 5.3	\$ 5.9	\$	0.6
Dept Justice Litigation	0.3	0.3		0.0
PHHS Fiscal 2002 cost over-run		3.9		3.9
Wildfire Costs, fiscal 2003		7.3		7.3
Total Likely Supplementals	<u>\$ 5.6</u>	<u>\$ 17.4</u>	<u>\$</u>	<u>11.8</u>
<u>Potential Cost Over-runs</u>				
PHHS - Medicaid Waiver		\$ 2.8	\$	2.8
Corrections - Prison Population		9.0		9.0
Total Potential Supplementals	<u>\$ 5.6</u>	<u>\$ 29.2</u>	<u>\$</u>	<u>23.6</u>

As shown in the bottom half of the table, there are two other areas with potential cost over-runs, based on current information, that could result in supplemental requests. They include an additional \$2.8 million in Public Health and Human Services and up to \$9.0 million in Corrections. The legislature should be aware of these potential over-runs, but understand that the executive has the option to mitigate those cost over-runs by re-prioritizing or applying cost saving measures. The executive has not stated whether these cost over-runs will be mitigated. The \$2.8 million in PHHS is due to planned reductions that are contingent on receiving a Medicaid cost waiver

from the federal government in fiscal 2003. Based on the length of time other states have experienced in obtaining the waiver, it is unlikely the waiver will be approved in time to obtain a fiscal 2003 savings. Since the department has already had to make significant reductions to stay within the fiscal 2002 budget, as part of fiscal 2003 reductions directed by the Governor, and incurred special session reductions that were not considered in the most recent cost projections, it will be difficult to mitigate the over-run.

The potential \$9.0 million cost over-run in Corrections is due to greater than anticipated prison population projections, reductions due to 17-7-140, and the special session. The legislature considered legislation in the special session to reduce total prison populations, but they were not adopted. If this cost over-run cannot be fully mitigated, there is a likelihood of a supplemental request for the 2003 biennium.

If the full amount of all of the four potential supplemental requests excluded from the legislative projections were to occur, the final ending fund balance could be expected to be \$23.6 million less, or down to \$3.5 million.

Economic Outlook/Revised Revenue Estimates

State revenue collections have continually worsened as compared to projections since November 2001. It remains unclear to what extent the downturn in collections seen in fiscal 2002 will continue into fiscal 2003. There are currently strong concerns the national economy will dip back into a recession. And there are concerns that capital gains revenue reporting could drop even further. Both the executive and legislative staffs will continue to monitor revenue collections closely. Any unforeseen economic shifts, which could include terrorist acts, reduced investor confidence, severe drought, or new federal tax legislation, could result in revised revenue projections that could worsen the current outlook. And since the projected balance is only \$1 million above the statutorily required fund balance reserve, there is no margin for error. A significant drop could require either an additional round of reductions or resolution by the legislature in the 2003 session.

2005 BIENNIUM OUTLOOK

The current broad-brush projection for the 2005 biennium is an imbalance of over \$230 million just to fund a baseline budget. The size of the imbalance is a major fiscal issue that will have to be addressed by the 2003 legislature. An accurate estimate of the imbalance is difficult to predict, since it is dependent on the strength of state and national economies and the growth rate in state expenditures as a result of caseload, population, and other increases.

Deteriorating Tax Base

It has become clear that the state general fund tax base has declined, primarily with regard to individual and corporate income tax collections. The prevailing question is how soon and to what extent the base will recover. The state's tax base increased significantly on the volume of capital gains increases that were reported during the extraordinary bull market years of the 1990s. The associated tax revenues were used to expand the expenditure base. It is now clear that the revenue bubble from capital gains income growth has burst, resulting in a permanent reduction in the general fund revenue base. An accurate analysis of the impact of capital gains revenue declines will not be possible until late 2002.

Structural Imbalance

LFD staff kept a constant tally of the potential structural imbalance in the general fund during the 2001 session, and reported in the post-session Legislative Fiscal Report that there was a structural imbalance of \$57 million in the 2003 biennium budget. A structural imbalance means that the on-going expenditures base exceeds on-going revenues by \$57 million (this was largely attributable to spending down a large fund balance, a one-time source of revenue, to support expanded or new programs). As projected by this office, the general fund revenue shortfall from HJR 2 levels is \$153 million. To the extent that this shortfall is permanent, a direct increase in the structural imbalance is created. Based on the LFD projections, the structural imbalance has grown to over \$230 million. This represents the reduction in revenues that are available to the legislature to continue ongoing programs, and when coupled with the costs of annualization of delayed implementation programs, such as the state pay plan and K-12 BASE aid increases, the shortfall mushrooms to over \$250 million. With the potential of anemic growth rate in general fund revenues, the legislature may have to consider significant budget reductions and/or revenue enhancements to balance the budget.

Impact of Special Session Actions – One-time vs. Ongoing

The legislative budget balancers enacted in the special session include \$33.0 million of one-time-only actions. However, the balancers include \$6.6 million of ongoing savings, and an additional \$19.3 million in potential on-going savings. To the extent that the legislature during the 2003 regular legislative session incorporates the fiscal 2003 special session budget balancers in each year of the 2005 biennium budget, the structural imbalance will be reduced correspondingly.

Expenditure Pressures

Pressures on spending for government services, including double-digit growth in human services programs (resulting from increased caseloads, Medicaid cost increases, and runaway prescription costs) will further complicate the budget deficit in the 2005 biennium. Corrections costs due to a filled-to-capacity prison system will further add to spending pressures. Demands for increased support of education will continue to be heard, and wildfire suppression costs may exceed average annual costs until the drought fully subsides. This will make the job of prioritizing/scaling back the expenditure base extremely difficult.

POTENTIAL BUDGET MANAGEMENT TOOLS IN 2003 SESSION

As part of a long-term solution to the current budget crisis, the legislature may want to evaluate options for improved budget management and tools to address temporary downturns in the state budget picture. The following discussion addresses three options for managing future budget deficit crises. These and other budget management options will be addressed further in the LFD Budget Analysis Report for the 2003 session.

Assessment of Appropriate General Fund Reserve

The economic outlook for the state is very tenuous at best. The more stable and robust economic times of the 1990's are in the past. Attaining general fund budget stability is more than setting appropriations equal to anticipated revenues. There is a need for a positive ending fund balance projection to serve as a safety net. The adequacy of the reserve can buffer the state from the consequences of fiscal instability due to the volatility in revenue collections. The level of fund balance reserves must be sufficient to offset unforeseen economic events that trigger shortfalls. To this end, the legislature needs to evaluate what amount of ending fund balance is sufficient to ensure budget stability.

For several biennia during the 1990s and before, the legislature set an ending fund reserve of \$20 to \$25 million, which was barely 1 percent of biennial appropriations. This reserve was near the trigger amount for spending reductions defined in statute. National fiscal experts such as the National Conference of State Legislatures recommend a fund balance reserve of 3 to 5 percent of total appropriations or revenues. At the current budget level, this would amount to a reserve of at least \$80 million. The average state reserve projection in fiscal 2001 was over 5 percent. The 2001 Montana legislature established the largest projected reserve in history when it set the 2003 biennium projected ending fund balance at \$54 million, or just over 2 percent of total appropriations. While still well below the recommended level and the all-state average, this ending fund balance reserve was not enough to avoid a budget deficit. The higher reserve did contribute to reducing the size of the deficit. This points out the importance of establishing an adequate reserve that takes into consideration the volatility of the state economic picture.

Attention to Structural Imbalance

The legislature has worked diligently to pass a budget that is structurally balanced over the past several biennia. The budget pressures of the 2001 session resulted in a general fund budget that was structurally imbalanced by at least \$57 million. This built-in imbalance, when coupled with the dramatic decline in general fund revenues has expanded the structural imbalance to \$230 million. This creates a serious underlying budget imbalance that will have to be addressed by the 2003 legislature. Establishment of balance between the ongoing revenues and the expenditures is critical to long-term budget stability. The LFD staff will continue to track the structural balance during the session to assist the legislature in achieving a healthy budget base structure.

Establishment of Rainy Day Fund

The current crisis in state general fund budgets has forced at least 48 states to take action to bring their budgets back into balance due to revenue shortfalls. A majority of those states utilized the proceeds of a rainy day fund as part of the solution to their budget shortfall. A total of 46 states have rainy day funds to help get through periods of budget volatility. One of the four remaining states has a statutory requirement that the minimum ending fund balance projection must be at least 7.5 percent of total revenues, which has the same effect as a rainy day fund. A rainy day fund is a prudent tool to avoid the

disruption of state services and the crisis management necessary in a budget deficit situation. Rainy day funds usually have strict criteria for withdrawal of funds from the account, and have effectively served states that invested in them.

INTRODUCTION TO AGENCY BUDGETS

The following section is an agency-by-agency summary of actions taken by the legislature in special session. Each agency narrative is structured as follows:

- 1) A table showing:
 - (a) The HB 2 fiscal 2003 appropriation as established by the legislature in regular session
 - (b) The HB 2 fiscal 2003 appropriation as adjusted by the legislature in special session
 - (c) The difference between the two
 - (d) The percentage change
- 2) A general listing of changes to the appropriation in HB 2
- 3) A discussion of any other legislation impacting the agency
- 4) A comparison to the executive recommendation
- 5) A table showing
 - (a) The original HB 2 appropriation
 - (b) The original HB 13 (pay plan) appropriation
 - (c) Adjustments to the appropriation made by the legislature in special session
 - (d) The total adjusted appropriation
 - (e) Spending reductions ordered by the Governor under the authority of 17-7-140
 - (f) The total financial impact to the agency of legislative appropriation adjustments and spending reductions ordered by the Governor

The section begins with a discussion of four actions taken by the legislature with either a global impact to all agencies, or from which a number of agencies were impacted: 1) the HB 3 general fund pay plan appropriation reductions; 2) the hiring freeze; 3) global across-the-board general fund reductions; and 4) the transfer of funds from the state workers' compensation "old fund".

For a discussion of the 17-7-140 spending reductions, please refer to the Legislative Fiscal Division publication entitled "Spending Reductions Proposal Fiscal 2003" available through the Legislative Fiscal Division offices or on the Internet at <http://leg.mt.gov/fiscal/index.htm>. This Internet address also houses first level tables for each program in each agency for purposes of Section 2 of HB 2 (August 2002 Special Session) and 17-7-138 and 17-7-139, MCA.

SHARED OR GLOBAL ISSUES

The following discusses action by the legislature with a global or shared impact.

PAY PLAN REDUCTION

HB 3 reduces the general fund appropriations to implement the 2003 biennium pay plan (HB 13 in the 2001 regular session) by 20 percent. The bill also reduces the contingency fund appropriated to assist agencies unable to meet their original vacancy savings targets. The reduction has the impact of increasing each agency's target vacancy savings rate.

The following summarizes the impact by area of government. The increased reduction to the executive branch was due to anticipated funding switches that would have reduced general fund appropriations to certain agencies and replaced it with other revenues. Only a portion of these switches was made.

Impact of Reductions to Pay Plan Appropriations General Fund, Only** Fiscal 2003				
Entity	Original Appropriation	Reduction	Total	Percent Reduction
Legislative Branch	\$ 388,359	\$ (77,672)	\$ 310,687	-20.0%
Judiciary	253,634	(50,727)	202,907	-20.0%
Montana University System	8,759,051	(1,751,810)	7,007,241	-20.0%
Remaining Executive Branch	11,606,426	(2,430,331)	9,176,095	-20.9%
Executive Branch Teachers	107,216	(21,443)	85,773	-20.0%
Contingency Fund*	<u>1,300,000</u>	<u>(500,000)</u>	<u>800,000</u>	-38.5%
Total	<u>\$ 22,414,686</u>	<u>\$ (4,831,983)</u>	<u>\$ 17,582,703</u>	-21.6%
*Biennial appropriation.				
**Other funds were increased by \$261,651 to account for anticipated fund switches. Only a portion of the fund switches were actually made.				

The impact of the reduction on each agency is listed in the agency narratives beginning on page x, and will differ from agency to agency depending upon the degree of general fund support in each agency. The following provides a sampling of agency impact on total agency appropriations. The table does not incorporate any other reduction measures, such as the 1 percent across-the-board reduction, that also only impacted general funded agencies.

**Impact on Selected Agencies
20 Percent Pay Plan Reduction Proposal
Fiscal 2003**

<u>Agency</u>	<u>Fiscal 2002* General Fund PS Funding %</u>	<u>Reduction in Total Pay Plan Funding</u>
Judiciary	87.5%	17.5%
Legislative Branch	67.8%	13.6%
Department of Transportation	0.0%	0.0%
Public Health and Human Services	56.0%	11.2%
Department of Natural Resources and Conservation	57.9%	11.6%
Department of Corrections	90.7%	18.1%
Office of Public Instruction	42.7%	8.5%
*Through June.		

HIRING FREEZE

HB 12 imposes a hiring freeze in fiscal 2003 on all agencies of state government, with the exception of the Montana University System. An agency may fill a position only with the approval, in writing, of the agency's approving authority³ to "...protect the public health, safety, and welfare of the citizens of the state and to avoid significant disruptions to critical state services." Expected savings total \$1.4 million general fund and are assumed as an increase in the anticipated general fund balance. No reductions were made to the appropriations of individual agencies as a result of passage of this bill.

The overall impact on individual agencies of the hiring freeze, the reduction in the pay plan appropriation, and the overall reductions imposed on agencies (most notably the 1 percent across-the-board reduction) will vary, as the degree of general fund support is not uniform, and some agencies had either already implemented various personal services cost saving measures to meet earlier reduction targets.

ACROSS-THE-BOARD REDUCTIONS

The legislature imposed three across-the-board reductions to fiscal 2003 general fund appropriations.

- 1) A 1 percent reduction to all general fund totaling \$4.4 million
- 2) An amount equivalent to 25 percent of all office-related supplies expenditures in fiscal 2002 totaling \$0.6 million
- 3) An amount equivalent to 66.7 percent (2/3) of all general fund equipment budgets in fiscal 2003 totaling \$2.8 million

³ The Governor or their designated representative for the Executive Branch, the Board of Regents for the Montana University System, the Supreme Court for the Judiciary, the Speaker of the House for the House of Representatives, the President of the Senate for the Senate, the Legislative Finance Committee for the Legislative Fiscal Division, the Legislative Council for the Legislative Services Division, and the Legislative Audit Committee for the Legislative Audit Division.

All agencies with general fund appropriations were impacted with the following exceptions:

- 1) The Department of Corrections was exempted from the 1 percent reduction (\$974,202)
- 2) The Department of Public Health and Human Services was exempted from a portion of the 1 percent reduction (\$731,008, with a further \$550,000 replacement of total reduced general fund with workers' compensation funds)
- 3) The Montana State Library Commission, the Judiciary, and the Forensics Division in the Department of Justice were exempted from the equipment reduction (\$362,677)

The impact of the reductions on each agency is discussed in the agency narratives that follow.

TRANSFER OF WORKERS' COMPENSATION FUND BALANCE

SB 19 transfers a total of \$4.0 million from the state workers' compensation "old fund" balance for four uses:

- 1) \$2.1 million to the K-12 flex fund for distribution to school districts. Along with an increase of \$2.0 million from the general fund, this action increases the total appropriation in the fund from the Governor's recommended \$200,000 to \$4.3 million.
- 2) \$550,000 to the Department of Public Health and Human Services to offset a portion of earlier reductions
- 3) \$79,326 to the State Library Commission to offset reductions in the equipment budget
- 4) \$1,270,674 to offset reductions in the Montana University System.

The bill also mandates a study of the structure of the state fund prior to the 2003 legislative session, with membership from the legislature, the state auditor's office, and insurers.

